

PERFECTION OF LIENS - IS A REFORM FROM PLEDGE TO FILING PREFERABLE?

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The current Swedish rules regarding perfection of liens are fragmented and their complexity often gives rise to complicated issues for courts to adjudicate. It is surely justified to debate the extensive benefits that could be achieved by an extensive reform of our security interest system. It is also relevant to question pledge as the predominant perfection method and in regards to this, to compare advantages and disadvantages between pledge and filing as the predominant perfection method.

The United States had a previous security interest system that in many parts was similar to the system that is present in Sweden today, a system that, according to the legislator, was regarded as too complex. As a response to the complexity, the first version of UCC Article 9 was created 1952.

In comparison with the current rules used in the U.S. this article intends to scrutinize and question the Swedish security interest system. A special focus will be aimed at the question whether filing is more suitable than pledge as the predominant perfection method.

I. INTRODUCTION

I.1 BACKGROUND AND PURPOSE

It has become even more important that financial regulations offer a safe and efficient way for capitalization in the aftermath of the last economic recession. It is normally a vital part in a basic lending transaction that the debtor grants a security interest in favor of the creditor. However, security interests have a great impact when a company or an individual seek funds for the performance of its business or the purchase of goods.

Nations have an important task to legislate security interest regulations that construct a well-adapted and beneficial climate for capitalization. Several questions arise from the context of regulatory issues, such as questions

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regarding validity of security agreements, achievement of perfection, priority among competing creditors, enforcement etc.²

The purpose of this article is to examine the suitability of the Swedish rules regarding perfection of liens in personal property. The existing Swedish rules are fragmented and lack unanimity.³ It is this article's intention to scrutinize whether Sweden ought to reform these rules. The article has its starting point in a comparison with the relevant rules in the United States, UCC Article 9. This article will also scrutinize the question whether filing, as the predominant perfection method, is a better and more efficient perfection method than pledge.

2. VALIDITY AGAINST THIRD PARTIES

2.1 FUNCTION AND BACKGROUND

Possession of a lien has no economical value per se.⁴ Instead, it is a guarantee for repayment, normally of a debt, upon a debtor's default.⁵ The instrument supports granting of credit and capitalization, since the lien holder's priority to the collateral enhances the willingness to provide credit.⁶ The lien agreement (i.e. a security agreement) is, despite its purpose, not sufficient enough to protect a creditor against certain third party claims. Such a complete shield is only achieved upon perfection of the security interest. The moment of perfection is therefore extremely important in order to maximize the benefits mentioned above. The requirements of perfection thus call for great attention since failure to comply imposes a great risk of credit loss upon the creditor.⁷

The Swedish rules regarding perfection are fragmented; it is often left to the courts to adjudicate complicated and important problems within this area of law.⁸ Below follows a description of the different methods of perfection in Swedish law, pledge, notification, filing and lastly other rules of perfection via some specialized instruments.

2 Whaley, Douglas J, *Problems and materials on commercial law*, 9th ed., 2008, p. 753.

3 Helander, Bo, *Kreditsäkerhet i lös egendom*, Stockholm 2008, p. 756.

4 Walin, Gösta, *Panträtt*, Stockholm 1991, p. 21.

5 Zackariasson, Laila, SvJT, *Svensk rättspraxis – Sakrätt 1982-2001*, 2003, p. 753 – 956, p. 837 f.

6 Hästad, Torgny, *Sakrätt avseende lös egendom*, 6th ed., Stockholm 2001, p. 282.

7 Helander, *Kreditsäkerhet i lös egendom*, p. 22 ff.

8 Helander, *Kreditsäkerhet i lös egendom*, abstract.

2.2 PLEDGE

Pledge (lat. *traditio*) is the dominant method for a creditor to achieve perfection in lien. Perfection is accomplished when the pledgor pledges the collateral into the possession of the pledgee, either directly from the pledgor or via a third party, holding possession of the pledgor's collateral.⁹ The Swedish Commercial Code (Sw: *Handelsbalken*), chapter 10 § 1 and the Promissory Notes Act (Sw: *Skuldebrevslagen*), 22 §, state that pledge requires a pledgee's possession of the collateral. The codifications do not state any other formal requirements regarding the lien agreement. Thus, an oral lien agreement is in addition to possession, all that is required.¹⁰

The requirement of the pledgee's possession of the collateral for the fulfillment of a valid pledge gives a false image of unity regarding the meaning of possession. The current legislation provides little guidance to its actual meaning.¹¹ Nevertheless, it is often clear whether possession of the collateral has passed from the debtor to the creditor. However, it is also true that in many cases it is ambiguous whether possession has passed or not.¹² The requirements for a valid pledge have been debated and they have generally been divided into three separate requirements.

- A. The pledgor must lose control of the collateral.
- B. The pledgee must have independent control over the collateral.
- C. The lien transaction must be open and published to third parties.¹³

The Supreme Court has in modern time considered loss of control as the material requirement for the occurrence of a valid pledge. Publicity and the pledgee's independent control are thus no longer decisive for pledge's validity.¹⁴

Lastly, the pledgor's loss of control must be satisfied throughout the entire duration of the security interest period. This requirement is according to *Hessler* motivated by the increased risk of non-equal treatment of the existing

9 Walin, Panträtt, p. 75.

10 Walin, Panträtt, p. 81.

11 Helander, Kreditsäkerhet avseende lös egendom, p. 375 ff.

12 Helander, Kreditsäkerhet avseende lös egendom, p. 375 ff.

13 NJA 1956 s. 485.

14 NJA 1986 s. 217; NJA 1989 s. 705; NJA 1996 s. 52; NJA 2000 s. 88; NJA 2008 s. 684.

creditors.¹⁵ The condition is pursuant to *Helander* justified by the fact that a lien transaction increases the risk of fraudulent transactions.¹⁶ This requirement is nevertheless not absolute; exceptions exist, such as when the pledged collateral by mistake has returned to the pledgor's control.¹⁷

Below follows a brief presentation of the first requirement, together with a case-law based exemplification of the how the Supreme Court has ruled in cases involving its application.

2.2.1 LOSS OF CONTROL

The use of a standard based upon a pledgor's loss of control still leaves issues for the courts to decide. A new concept in the need for definition is created and many authors have tried to explore its content.¹⁸ The prevalent meaning in authoritative literature and case-law is that the determinative feature is the pledgor's possibility of disposal of the pledged collateral. Whether this disposal has been duly authorized or not is not decisive. The determinative factor is instead solely based upon the pledgor's possibility of disposal.¹⁹ The following three Supreme Court cases illustrate that the establishment of loss of control can sometimes be far from simple and obvious to the parties involved in a pledge transaction.

i. *NJA 1956 s. 485* – A question arose in a bankruptcy whether the creditor (a bank) had a perfected security interest or not. The bankruptcy trustee claimed, *inter alia*,²⁰ that the debtor had not lost control over the collateral and that the security interest therefore had not attached. The creditor had changed the padlocks on the hatch normally used to gain access to the collateral, the seed. The debtor could though still access the seed through roof hatches used for replenishment and taking of specimens. Access could thus only be gained via costly and unusual measures. The Court of Appeal held, and the Supreme Court affirmed, that the fact that the debtor could access the collateral through the roof hatches did not create lack of perfection. The

15 Hessler, Henrik, *Allmän sakrätt: om det förmögenhetsrättsliga tredjemansskyddets principer* [cite: *Allmän sakrätt*], Stockholm 1973, p. 361 f.

16 Helander, *Kreditsäkerhet avseende lös egendom*, p. 400.

17 *NJA 1958 s. 422*.

18 Myrdal, Staffan, *Några synpunkter på borgenärsskyddet*, JT 2003/2004, vol 5, p. 472.

19 Myrdal, Staffan, *Borgenärsskyddet*, 1st ed., Stockhom 2002, p. 80.

20 Other claims made by the bankruptcy trustee concerned lack of the pledgee's control and lack of publicity.

pledgor had lost his control of the collateral since he could not gain access to it via normal measures. A valid pledge had thus come into existence.

ii. *NJA 1986 s. 409* – A son (the debtor) borrowed money from his mother (the creditor). The mother received a lien in the son's hunting weapons to secure the debt. The rifles were locked inside a special locker designed to contain weapons. Both the son's mother and father possessed keys to the locker and the son would thus have to ask for the keys to gain access to the weapons. The enforcement service (Sw: *Kronofogdemyndigheten*) held the pledge to be invalid and seized the weapons while seeking recovery for the son's unpaid tax debts. The father's testimony in court stated that the son was always allowed access to the weapons if he so wanted. The Court of Appeal held, and the Supreme Court affirmed, that the son, even after the weapons had been used as collateral had an unfettered opportunity to dispose them. Thus, the court held that the son did not lack control over the collateral and the pledge were therefore ruled to be invalid.

iii. *NJA 1996 s. 52* – X received a lien in a negotiable promissory note stored in an open bank deposit. The Supreme Court held that Y (the pledgor) still had control over the collateral since he had not pledged it unconditionally. Y had reserved his right to, in community with X, recapture the collateral from the bank deposit. The Supreme Court therefore ruled the loss of control to be insufficient, since the pledge was conditional.

2.3 NOTIFICATION

Perfection of a lien in goods which are in possession of a third party is achieved by notification to the third party of the lien agreement's existence, given by either the pledgor or the pledgee. A valid notification to a third party by the pledgee requires, according to Act (1936:88) regarding collateral in chattels²¹ in the possession of a third party (Sw: *Lag om pantsättning av lös egendom som innehaves av tredje man*), that the notification undertakes the showing of the lien agreement to the third party. No such requirement is upheld if the notification instead is made by the pledgor.²² If a lien exists in personal property not possible of possession, i.e. intangibles such as non-negotiable promissory notes, then the notification shall be made in accordance with the Promissory Notes Act, 31 § (Sw: *Skuldebrevslagen*). It must then be made to

21 Def: a movable article of personal property.

22 Act (1936:88) regarding collateral in chattels.

the pledgee from where the non negotiable promissory note originates. Thus, no showing of a written document is required.²³

2.4 REGISTRATION

Some liens can neither be perfected by pledge nor notification. To accomplish perfection in a lien in vessels (larger than 12 x 4 meters) or in vessels under construction, the Maritime Act, chapter 3 (Sw: *Sjölagen*), requires registration and a subsequent pledge of the registration document to the pledgee. For a boat smaller than 12 x 4 meters, perfection will be accomplished through either pledge of the boat or by notification as discussed under sections 2.1 and 2.2. A lien sought in an aircraft also requires registration.²⁴

Another nonpossessory security interest recognized under Swedish law is the business mortgage (Sw: *Företagshypotek*), which is a floating charge on substantially all property of a tradesman or company. Perfection is achieved by registration in the Register of Chattel Mortgages (Sw: *Företagsinteckningsregistret*). The charge does not attach to specific assets until an event of crystallization, such as bankruptcy of the debtor. The debtor can, prior to crystallization, transfer collateral to a bona fide purchaser, free and clear of the business mortgage. Thus, the purchaser will have rights in the collateral superior to the rights of the bankruptcy estate, business mortgagees and judgment creditors.²⁵

2.5 SPECIAL CONSIDERATIONS

No solution is offered to a creditor who wants to use a nonpossessory security interest in a debtor's chattels without applying the business mortgage instrument. This precludes a creditor's possibility to perfect a security interest in a single chattel belonging to the debtor. This can however be avoided via a reclassification. A security interest disguised as a transition of legal ownership results in the applicability of the Sale of Chattels Act (Sw: *Lösöreköplagen*). The buyer (the creditor) achieves a perfected interest, in the "purchased" chattels remaining in the care of the seller (the debtor), when the buyer's (creditor's) rights have been registered and publicly proclaimed in the specific manner required. The seller (debtor) has, as soon as his/its obligations are fulfilled, the

23 Håstad, *Sakrätt avseende lös egendom*, p. 302 f.

24 The Swedish Commercial Code, chapter 10 § 7; Håstad, *Sakrätt avseende lös egendom*, p. 301 f.

25 Rosenberg, Arnold S, *Where to File Against Non-U.S. Debtors: Applying UCC § 9-307(c) [Rev] to Foreign Filing, Recording, and Registration Systems*, UCC Law Journal, vol 39 2006, p. 60.

right to repurchase the sold goods. Likewise, the buyer (creditor) has the right upon the seller's (debtor's) default to receive the goods and, through a sale of the purchased goods, cure the non fulfillment of the obligation.²⁶

The use of conditional sale basically gives a seller the opportunity to have a lien in sold goods until it is fully paid and the transition of legal ownership will hence not occur until the purchase price is fully paid. This creates another situation where the collateral is under the pledgor's control instead of the pledgee. *Håstad* argues, that exceptions like these undermine the importance of the perfection rules discussed in section 2.1 – 2.3, due to the fact that the collateral is allowed to remain under the pledgor's control.²⁷

3. POLICY ARGUMENTS AND PURPOSES

3.1 INTRODUCTION

Helander concludes that there are many reasons why pledge and other methods of achieving perfection cannot be regarded as having intrinsic value. Their existence must instead be justified by reasonable grounds.²⁸ It is hence logical for this article to use these reasonable grounds when investigating whether filing offers a better perfection method than pledge.

3.2 PUBLICITY

Publicity has been seen as an instrument to help potential creditors in their valuation of a debtor's creditworthiness. A creditor should be able to proceed with the assumption that all property in the possession of the debtor would be available for execution upon the debtor's default, unless another inference could be drawn from the contents of certain registers. The purpose is today, according to authoritative literature, lacking in substance. It is nowadays not unusual that debtors are in possession of property either as a credit sale or as a hire. These forms of possession do not affect the debtor's total amount of assets and can therefore misrepresent the creditworthiness.²⁹ Another argument for its lacking importance is, that there are no guarantees that the property in the debtor's possession remains in the debtor's possession at the time of default.³⁰

26 *Håstad, Sakrätt avseende lös egendom*, p. 294.

27 *Håstad, Sakrätt avseende lös egendom*, p. 294.

28 *Helander, Kreditsäkerhet avseende lös egendom*, p. 349.

29 *Håstad, Torgny, The Importance of Tradition*, Stockholm 1982, p. 10.

30 *Johansson, Morgan, Ändamålsenliga sakrättsmoment – om rådgighet, sken och rådgighetssken [cite: Ändamålsenliga sakrättsmoment]*, SvJT 1997, p. 346; *Helander, Kreditsäkerhet avseende lös*

Helander is of the opinion that the criticism is justified. However, he also states that there still could be some credit transactions of a more unsophisticated nature where the potential debtor's possessed assets could have an effect upon a prospective credit transaction. He further declares that the mere fact that the debtor possesses some goods in the form of a lease or through a credit sale should not come as a surprise to the creditors since both these instruments are well-known phenomena.³¹

The requirement for a method of perfection gives a third party, who is on the verge of concluding a purchase agreement, lien agreement, etc., an opportunity to be acquainted with the legal status of the goods. This discloses the fact that the goods already are e.g. burdened with a lien. This is also the key feature in preventing a debtor from having the opportunity of disposing of the collateral twice, unless the second creditor consents to use collateral in which he will not receive the highest priority.³² Thus, publicity protects later pledgees and other acquirers of the collateral from acquiring rights in collateral which is already burdened with an attaching security interest.

3.3 FRAUDULENT TRANSACTIONS

Perfection is often legitimized by its preventive effect on sham and antedated transactions. This purpose is often, if not always, regarded as the most important one.³³ Protection is primarily sought against a debtor that by unfair means attempts to "rescue" property, from the effects of bankruptcy or other economic situations of demanding character.³⁴ Pledge, notification and registration are consequently used to control (since a third party becomes a witness to the transaction) and objectively determine a time for when perfection is achieved, which complicates fraudulent transactions.³⁵ A bankruptcy trustee's remedy is to use the rules of reclamation in the Swedish Bankruptcy Act (Sw: *Konkurslagen*), to reclaim assets affected by a fraudulent transaction.³⁶ One problem still remains. As expressed by *Göransson*, "it takes two to tango". This vivid saying basically identifies the problem that it is not always an external

egendom, p. 351 ff.

31 Helander, *Kreditsäkerhet avseende lös egendom*, p. 353 f.

32 Helander, *Kreditsäkerhet avseende lös egendom*, p. 355.

33 NJA 1979 s. 451; NJA 1987 s. 3; NJA 1988 s. 257; NJA 1995 s. 367; NJA 1998 s. 545.

34 It is without a special survey hard to establish to what extent the perfection rules prevent sham and antedated transactions, although, it seems generally accepted that this effect actually exists; Myrdal, *Borgenärsskyddet*, p. 43.

35 Helander, *Kreditsäkerhet avseende lös egendom*, p. 359 f.

36 Helander, *Kreditsäkerhet avseende lös egendom*, p. 360 f.

and credible person that participates in and/or views the transaction. This undermines the efficiency of the mentioned purpose, since a debtor who wants to perform a sham or antedated transaction needs an accomplice to be able to succeed with his intentions. *Göransson* extends his conclusion by saying that the current Swedish system may endanger creditors, since a debtor together with his accomplice could orchestrate a pledge without major difficulties that falls outside the applicability of the reclamation remedy.³⁷

3.4 ORDERLINESS

Hellner views the creation of orderliness as being more important than any other purpose. Perfection creates a safe and easily determinable fact that a court can base its adjudication upon in a priority dispute regarding collateral.³⁸ *Helander* describes perfection as something that creates a reasonably simple and objective finding of fact, which he concludes will lead to a reduced amount of priority conflicts. *Helander* notes that this purpose is mostly to serve as a protection for creditors.³⁹ However, *Göransson* states that the view that orderliness would prevent disputes does not seem to be accurate. He states that the establishment and determination of whether a valid pledge exists is far from simple and obvious in all cases. The question does *per se* create disputes. This is according to *Göransson* the reason why a statement which purports that the use of pledge decreases priority conflicts seems to be inaccurate.⁴⁰ *Myrdal* says that it is in the interest of the commercial climate that complicated priority disputes are avoided. Furthermore, he seems to be of the opinion that the existing perfection methods in Sweden have a decreasing effect upon the amount of priority conflicts, regardless of *Göransson's* criticism.⁴¹

3.5 SURRENDER OF CONTROL

The surrender of control of the collateral, involved when a debtor pledges the collateral into the hands of a creditor, has been seen to prevent the debtor from entering into thoughtless lien agreements. The purpose is essentially to prevent debtors from living beyond their assets and to support the existence of a healthy credit market.⁴² *Myrdal* concludes that the purpose of surrender is not

37 Göransson, Ulf, Traditionsprincipen, De svenska reglerna om köparens skydd mot säljarens borgenärer i komparativ och historisk belysning [cite: Traditionsprincipen], Uppsala 1985, p. 645.

38 Hellner, Jan, Speciell avtalsrätt I köprätt, Stockholm 1982, p. 251.

39 Helander, Kreditsäkerhet avseende lös egendom, p. 362.

40 Göransson, Traditionsprincipen, p. 634 ff.

41 Myrdal, Borgenärsskyddet, p. 49.

42 Helander, Kreditsäkerhet avseende lös egendom, p. 362.

an independent purpose; rather it is an underlying purpose to the prevention of fraudulent transactions.⁴³ It has also been stated that the surrender of control serves to protect unsecured creditors in a bankruptcy procedure. The rationale behind this statement, is the fact that the assets the debtor cannot afford to surrender will be subject to unsecured creditors' claims. The question is to what extent this purpose has relevance; its preventive effect can, according to *Helander*, be debated.⁴⁴ He concludes that it is conspicuous that not all perfection methods require the debtor's surrender of control of the collateral, e.g. the business mortgage. *Hessler* is of the opinion that the meaning of surrender can vary in different contexts. He concludes that surrender sometimes can be fulfilled by the fact that the existence of a security interest in goods becomes public. Prospective creditors can then by use of their knowledge of the security interest choose not to enter into a credit transaction with the debtor. This could, according to *Hessler*, to some extent and in some contexts, also be viewed as a surrender of control.⁴⁵ *Helander* further states that it may be hard to establish if the surrender would have any *de facto* effect upon the protection of unsecured creditors. It is a fact that unsecured creditors in most cases never receive any distribution from a corporation that undergoes a bankruptcy procedure, regardless of the existence or non-existence of surrender.⁴⁶ *Johansson* says that if the requirements of perfection can be motivated in any other way, the purpose of surrender can be left without regard.⁴⁷

3.6 THE PLEDGEE'S CONTROL OF THE COLLATERAL

A strong reason that legitimizes pledge as a way to achieve perfection is the fact that the pledgee has the actual control over the collateral. *Helander* does not see this as an end in itself. Instead, it serves to protect the pledgee from the pledgor's possible use of the collateral that will extinguish or damage the pledgee's rights to the collateral. It is also considered that the pledgee's control will generate practical opportunities to collect from the collateral against a defaulting pledgor.⁴⁸ *Helander* is unsure if this could be regarded as a purpose since it does not protect any third party interests like the other purposes. It only relates to and affects the relationship *inter partes*. The pledgee's control of the collateral should thus not be seen as a purpose and a requirement for valid

43 Myrdal, Borgenärsskyddet, p. 45 ff.

44 Helander, Kreditsäkerhet avseende lös egendom, p. 362 ff.

45 Hessler, Allmän sakrätt, p. 353.

46 Helander, Kreditsäkerhet avseende lös egendom, p. 364.

47 Johansson, Ändamålsenliga sakrättsmoment, SvJT, p. 347.

48 Helander, Kreditsäkerhet avseende lös egendom, p. 364 f.

perfection.⁴⁹ The lack of the pledgee's control of the collateral has, according to the Swedish Supreme Court's rulings, not been held to be decisive for the determination of the existence of a valid pledge.⁵⁰

4. UCC ARTICLE 9

4.1 HISTORY AND BACKGROUND

Subsection §9-109 (a)(1) of the UCC Article 9 creates the following basis of its applicability:

“Except as otherwise provided in subsections (c) and (d), this article applies to: (1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;...”

The security devices, pre UCC Article 9, in the U.S. security interest system were piecemeal in a way similar to the current situation existing in Sweden. Security interests were created by the use of pledge, trust receipt, chattel mortgage, conditional sale, factor's lien and field warehousing.⁵¹ The above cited article thus creates the foundation of the uniformity required to avoid the issues herein exemplified. Hence, the subsection is of major importance due to its “umbrella” function, collecting all security interest devices, regardless of their form, under the applicability of the same rules, UCC Article 9.⁵²

However, the requested result from the reform and its underlying objectives and policies that today permeate the UCC Article 9 are “a) to simply, clarify and modernize the law governing commercial transactions; b) to permit the continued expansions of commercial practices through custom, usage and agreement of the parties; c) to make uniform the law among the various jurisdictions”.⁵³

4.2 THE SCOPE OF ARTICLE 9

Article 9 primarily covers consensual security interests in personal property and fixtures. The applicability of Article 9 is generally, according to § 9-109(a) (1), to “a transaction, regardless of its form, that creates a security interest in

49 Helander, *Kreditsäkerhet avseende lös egendom*, p. 364 ff.

50 NJA 1996 s. 52; NJA 2000 s. 88.

51 Whaley, *Problems and Materials on Commercial Law*, p. 755 ff.

52 Helander, *Kreditsäkerhet avseende lös egendom*, p. 81.

53 UCC §1-102(2).

personal property or fixtures by contract”. The definition of a security interest is hence of a fundamental importance. Section 1-201(37) UCC states that a “security interest means an interest in personal property or fixtures which secures payment or performance of an obligation...”. The parties’ intention and the function of the agreement is for this reason the determinative factor that the courts look at when they determine whether Article 9 applies to the contract or not. As a result, the parties cannot render it inapplicable merely by casting their arrangement in the language of some particular pre-Code device or in the language of some other transaction, such as a lease.⁵⁴

4.2.1 CLASSIFICATION OF COLLATERAL

UCC Article 9 classifies personal property into different categories. The categorization is important since achievement of perfection varies depending on which category the collateral belongs to. It is thus important to briefly present this categorization to give the reader an opportunity to understand the systematization of Article 9.

Article 9 uses three main categories, which then categorize the collateral into subsections. The three main categories and their subsections are the following:

- i. *Goods* – defined as “...all things that are movable when a security interest attaches...”.⁵⁵
- ii. *Quasi-Tangible Property* – defined as a piece of paper used as collateral, e.g. stock, bonds and bill of lading.⁵⁶
- iii. *Intangible Property* – defined as property having no physical form, e.g. accounts, letter of credit rights and health care insurance receivables.⁵⁷

As mentioned above, the categorization is important since Article 9 makes many legal distinctions based upon the categorization. As an example, the technical steps required when perfecting a security interest in a negotiable instrument, a family car, or a hardware store’s inventory is completely different. It is the debtor’s announced use of the collateral that is the determinative factor

54 White James J, Summers, Robert S, Uniform Commercial Code, 6th ed., 2010, p. 1152 f.

55 UCC §9-102(a)(44); Whaley, Problems and Materials on Commercial Law, p. 791 f.

56 Whaley, Problems and Materials on Commercial Law, p. 791 f.

57 Whaley, Problems and Materials on Commercial Law, p. 791 f.

deciding the categorization of the collateral.⁵⁸ In, *In re Troupe*, the bankruptcy court said “the classification of the goods is to be determined as of the time of the creation of the security interest. The classification does not change because of a later change in manner in which the collateral is used...”.⁵⁹ Thus, the debtor’s intended use of the collateral at the time of the creation of the security interest is decisive for the classification.

4.3 CREATION OF A SECURITY INTEREST

A security interest is a bundle of rights in property – the collateral – which belongs to the secured party. The moment when the secured party obtains his security interest is under the UCC Article 9 called attachment.⁶⁰ It occurs when the security interest becomes enforceable against the debtor, with respect to the collateral, unless the parties in an agreement have expressly postponed it.⁶¹

Three requirements need to be fulfilled for the security interest to achieve attachment status, i.e. for it to become enforceable and valid against the debtor:

- i. either the collateral is by agreement in possession of the secured party or the debtor has authenticated a security agreement,
- ii. value is given from the creditor to the debtor, and
- iii. the debtor must have rights or the power to transfer rights in the collateral.⁶²

4.3.1 POSSESSION OR AUTHENTICATED WRITING

A contract between a creditor and a debtor, that personal property is to be used as collateral, can be made orally if the creditor is in possession of the collateral. However, an authenticated⁶³ writing is a requirement if the creditor

58 Whaley, *Problems and Materials on Commercial Law*, p. 791 f.

59 *In re Troupe*, 340 B.R. 86, 2006 WL 689515.

60 Nordstrom et al, *Problems and Material on Secured Transactions*, 1987, p. 113.

61 UCC §9-203(a).

62 LoPucki et al, *Commercial Transactions, A Systems Approach*, 4th ed, 2009, p. 826; UCC §9-203(a)-(b).

63 The security agreement must be authenticated by the debtor. Authenticated is normally defined as authenticated by a signature, but it is more widely defined in the context of the UCC, authenticated is according to UCC §1-201(b)(37) defined as, “any symbol executed or adopted by a party with present intention to authenticate writing”.

lacks possession of the intended collateral. The authenticated writing, i.e. a security agreement, is a contract in which the debtor grants the creditor a security interest in the collateral.⁶⁴

Another prerequisite for a valid security agreement is that the collateral is described, in order to enable identification of the collateral subject to the agreement. Identification is not necessary if the creditor either has control or possession of the collateral.⁶⁵ A super generic description of the collateral, e.g. “all the debtor’s assets”, is rejected. Instead the description is allowed only if it “reasonably identifies what is described”.⁶⁶ The UCC Article 9 thus allows description by category to reasonably identify the collateral.⁶⁷

4.3.2 VALUE HAS BEEN GIVEN

UCC §9-203(b)(1), requires for attachment that “value has been given”. It is not designated which party must give value, but it is logical and practical that it is the secured party that must give value, an interpretation that the courts have agreed upon.⁶⁸

A secured creditor typically gives value through a loan of money, by providing the debtor with a line of credit. However, value is also given when the creditor gives a binding promise to make a loan at some future date, acquires a security for a preexisting claim, by accepting delivery under a preexisting contract for purchase, or in return for any consideration sufficient to support a simple contract. The value requirement is thus broadly defined and easy to satisfy for a creditor.⁶⁹

4.3.3 THE DEBTOR HAS RIGHTS IN THE COLLATERAL

Nemo dat quod non habet – one cannot give what one does not have. This phrase describes the logical prerequisite that a debtor giving a security interest in personal property must have rights, or the power to transfer rights in the collateral. The debtor’s rights in the collateral are not determined by Article

64 UCC §9-102(a)(73); White & Summers, Uniform Commercial Code, p. 1187.

65 White & Summers, Uniform Commercial Code, p. 1187 f; UCC §9-203(b)(3).

66 UCC §9-110.

67 White & Summers, Uniform Commercial Code, p. 1188 f, UCC §9-108.

68 Nowka, Richard H, Mastering Secured Transactions: UCC Article 9 [cite: Mastering Secured Transactions], 2009, p. 30 f.

69 White & Summers, Uniform Commercial Code, p. 1192; Nowka, Mastering Secured Transactions, p. 30 f; UCC §1-204.

9, but rather by Article 2 and 2a of the UCC and common law. Rights in the collateral extend, in the context of the UCC Article 9, beyond title. It includes any case where the debtor has “the power to transfer right in the collateral to a secured party”. Hence full ownership is not required.⁷⁰ A debtor that acquires rights in the collateral at a later date, than the signing date of the security agreement, postpones the attachment of the security interest until the rights have been acquired.⁷¹

4.4 VALIDITY AGAINST THIRD PARTIES

The UCC offers different methods for a creditor to achieve perfection. Filing of a financing statement is the dominant method, supplemented by pledge and automatic perfection and also in some situations replaced by pledge and control. By pledging the collateral, i.e. a creditor takes possession over the collateral, perfection is achieved.⁷² It is, however, a fact that the UCC offers several perfection methods and sometimes requires perfection via other methods than filing.

4.4.1 FILING

The UCC states that, “except as otherwise provided⁷³ a financing statement must be filed to perfect all security interests and agricultural liens”.⁷⁴ Thus, a financing statement must be filed to perfect all security interests, and where a security interest is not within one of the exceptions, filing is essential for its perfection.⁷⁵ An important feature of the filing system in the UCC Article 9, is the fact that once a financing statement has been filed at the filing office it will be effective for five years. Thus, a creditor can take advantage of the same financing statement, when and if he extends more credit to the debtor, and still have the same priority standing in the collateral as of the date when he first filed the financing statement. This holds as long as the financing statement is valid. It is important to note that invalidity will not occur, *per se*, due to fulfillment of the debtor’s repayment obligation; hence, a termination procedure must be completed. *Helander* does not consider this as a weakness of the registration

70 White & Summers, Uniform Commercial Code, p. 1192.

71 Nowka, Mastering Secured Transactions, p. 31 f.

72 Whaley, Problems and Material on Commercial Law, p. 825.

73 UCC §9-310(b); UCC §9-312(b).

74 UCC §9-310(a).

75 Sommers v. International Business Machines, 640 F.2d 686, 30 U.C.C. Rep. Serv. 1757 (5th Cir. 1981); Witmer v. Kleppe, 469 F.2d 1245, 11 U.C.C. Rep. Serv. 838 (4th Cir. 1972); Bank of Drexel v. Kyser, Inc., 685 S.W.2d 230, 40 U.C.C. Rep. Serv. 1476 (Mo. Ct. App. W.D. 1984).

system; he rather sees it as a consequence of the chosen system. A creditor can protect himself by either requiring that a subordination agreement is signed by him and the secured party, or by requiring that a termination agreement is registered in respect of the secured creditor's financing statement.⁷⁶

4.4.1.1 BASIC REQUIREMENTS

UCC Article 9 upholds three initial requirements that need to be fulfilled for the financing statement to be effective. It must provide the name of the debtor, the name of the creditor or a representative of the secured party and also contain a description of the collateral subject to the financing statement.⁷⁷ Article 9 also contains certain additional requirements, for example, a financing statement is to provide a mailing address to the debtor, it must also be communicated in a medium that is authorized by the filing office and an amount equal or greater than the application fee must be tendered.⁷⁸

UCC Article 9 offers a uniform financing statement that has been adopted by most states in the U.S. The combination of the use of identical documents and the documents conformity with the requirements, should facilitate uniformity and also minimize the cases in which filing is done improperly.⁷⁹

4.4.1.2 DESCRIPTION OF THE COLLATERAL

Description of the collateral in the financing statement follows the same requirements as for description of the collateral in the security agreement. However, one major difference is that the requirement for description in the financing statement accepts super generic terms, such as, "all the debtor's assets".⁸⁰ The less stringent description requirement is explained by the fact that the financing statement only aims to create publicity of the fact that some of the debtor's property is subject to a security interest.⁸¹

4.4.2 FILING AND ITS BENEFITS

One of the fundamental reasons why pledge existed as a pre-Code method to perfect a security interest was because of its publicity-creating power. This power was still fundamental when filing was developed as a perfection method.

76 Helander, *Kreditsäkerhet avseende lös egendom*, p. 201 ff.

77 White & Summers, *Uniform Commercial Code*, p. 1218; UCC §9-502.

78 White & Summers, *Uniform Commercial Code*, p. 1219 f; UCC §9-516(b).

79 White & Summers, *Uniform Commercial Code*, p. 1223; UCC §9-521.

80 White & Summers, *Kreditsäkerhet avseende lös egendom*, p. 1228 ff.

81 Helander, *Kreditsäkerhet avseende lös egendom*, p. 178 f.

The drafters of the UCC drew their attention to the fact that filing set aside some of the deficiencies regarding pledge's publicity-creating power and that it more efficiently created publicity.⁸²

One aspect of the publicity requirement is that it provides third parties with information about the collateral. A third person who is about to acquire rights in the collateral can thus receive information whether the collateral is subject to a security interest or not. Furthermore, filing as a perfection method has a preventive effect upon sham and antedated transactions. These are two legitimizing reasons for the use of the method, which have been equivalently highlighted as two of the legitimate reasons for the use of pledge in Sweden.

Despite the fact that filing and pledge share many features in common, differences still exist. By the use of filing, determination of a time when the transaction took place is easier to establish. This creates facts upon which it is less problematic to determine priority conflicts, since the time for filing is often essential for such determination.⁸³

A difference when filing is used, in regards to pledge, is that the pledgee has to carry a special risk when the collateral remains in the possession of the pledgor. One concern is that a pledgor will probably not have the best interest of the pledgee in mind when he faces financial difficulties. The possibilities for the pledgor to act unfairly must therefore be considered as increased when filing is used. Also, the efficiency of filing's publicity effect will be dependent upon the formation of the filing system.⁸⁴

Authors of authoritative literature in the U.S. have claimed that it is obvious that filing will be the most dominant perfection method within the UCC. One of the reasons for this is that perfection through possession has been seen as costly and cumbersome in regards to many types of collateral.⁸⁵ *Spivak, inter alia*, states that the possessory type of security interest is suitable only in a limited number of situations. He says that the underlying purpose of

82 Helander, *Kreditsäkerhet avseende lös egendom*, p. 165 ff.

83 White & Summers, *Uniform Commercial Code*, p. 1194; Helander, *Kreditsäkerhet avseende lös egendom*, p. 165 f; Squillante, *Aplhonse M, Commercial Code Review, A summary of Leading Decisions and Articles*, Heinonline, 73 Com. L.J. 81 1968, p. 81.

84 Helander, *Kreditsäkerhet avseende lös egendom*, p. 165 ff.

85 Summers, Robert S, *Secured Transactions Under The Uniform Commercial Code*, *Commercial Law Journal*, Heinonline, 68 Com. L.J. 351 1963, p. 355.

Article 9 is to provide rules relating to secured transactions, which offer legal protection to the secured party, the debtor and to third parties, and at the same time permit the greatest economic benefit to society, by allowing the use of secured collateral. He continues, “if possession were the only method of perfection, substantially all financing of manufactures would cease and all installment buying by consumers would come to an end”. Possessory types of security devices, such as pledge, will, therefore, according to *Spivak*, mostly be used when the collateral’s economic utility is limited or non-existent.⁸⁶ It is worth noticing that *Spivak* is referring to the commercial reality that a pledgor often, within the operation of its business, has a need to maintain possession of the collateral. This should probably be considered as one of the main reasons why filing was chosen as the dominant perfection method in the United States.

5. ANALYSIS

5.1 THE BENEFITS OF A REFORM

Many benefits could be achieved by the use of the UCC Article 9 as a role model for a future reform of the Swedish security interest system. The use of a system that acknowledges transactions as security interests, regardless of their form, together with the use of filing as a perfection method, would create an opportunity to use almost all personal property as collateral. A reform would simplify, bring clarity and modernize the law governing security interests, a reform stands out as a necessity when compared to the current system with partial reforms that interacts in an unsatisfactory manner. A reformed system would provide a system which is better adapted to interactions between the different instruments.

The UCC Article 9 will offer a superior system in several respects. First of all, the Swedish security interest system does not offer an instrument that allows for perfection of a security interest in a single chattel that remains in the possession of the debtor. However, there are many transactions where the debtor needs to maintain possession of the chattel to be able to fulfill its obligations. This situation has been resolved by a reclassification of the transaction to achieve the applicability of the Sale of Chattels Act. A system like the UCC Article 9 would prevent the need of reclassification since it allows for the registration of a security interest in a single chattel. This avoidance has a value *per se* since it helps to bring clarity to an agreement’s actual content. Furthermore, the Sale

86 Spivak, Oscar, *Secured Transactions*, Joint Committee on Continuing Legal Education of the American Bar Association, 3rd ed. 1963, p. 78 f.

of Chattels Act provides for a grace period of 30 days before registration of the reclassified transaction becomes valid. Accordingly there is a period of 30 days in which the creditor will be subject to uncertainty and an enhanced credit risk due to the lack of perfection. The creditor also needs to give notice of the purchase (security interest) in the local newspaper of the seller's domicile, within seven days from the date of entry into the agreement. Furthermore, it is necessary to register the purchase (security interest) in the Enforcement Service's register within eight days from the notice.⁸⁷ The Sale of Chattels Act is thus a quite complicated system that requires several steps within specified timeframes. These complications will be precluded with a system like the UCC Article 9, since perfection will be concurrent with registration. It would also simplify the whole registration procedure since no timeframes would apply in which certain steps needs to be achieved, in which non compliance would preclude the possibility of registration of the actual purchase. Hence, a UCC Article 9 system offers, a definitive conclusion which is safer and more user-friendly than the applicability of the Sale of Chattels Act.

Secondly, the business mortgage has several disadvantages in comparison with the UCC Article 9 system. It requires pledging of the business mortgage certificate or registration in a register provided by the Swedish Companies Registration Office ("Registration Office") (Sw: *Bolagsverket*), to achieve perfection of the security interest.⁸⁸ A creditor that wishes to use the available registration method needs to apply to the Registration Office to be granted access to use the system. Not every creditor is thus allowed to use registration since it, e.g. requires access to certain technical equipment and knowledge. These creditors instead need to pledge the physical certificate to achieve perfection.⁸⁹ It is unfortunate to have two accessible methods to achieve perfection of a business mortgage, since it leads to complications. A business mortgage certificate that is perfected via registration, e.g. needs to be converted to a physical certificate if the new creditor is not granted the right to use registration to gain perfection. Such conversion must be viewed as inferior in comparison with a system that is uniform such as the UCC Article 9. Furthermore, the use of pledge of different physical certificates like a business mortgage certificate or a stock certificate could lead to complications due to, e.g. loss of the collateral. A lost certificate constitutes a higher risk of credit loss since it implies a difficulty for the creditor to prove perfection of its security

87 Sale of Chattels Act, § 1-2.

88 Floating Charge Register Act (SFS 2008:1075); Floating Charges Act (SFS 2008:990).

89 Floating Charge Register Act (SFS 2008:1075), § 12.

interest in the event of, e.g. bankruptcy. It is preferable to have a system that does not require pledge of stock certificates, business mortgage certificates and other similar securities to achieve perfection, since the system to a significant extent would be simplified due to the fact that the creditors will be spared from possession of valuable documents.

Thirdly, the system creates an easy method for potential creditors to scrutinize a debtor's assets, it would only need to search one uniform register to gain an understanding of almost all of the existing security interests. Complicated assessments of loss of control will to a significant extent be precluded if registration were to become the predominant perfection method. *Håstad* has summarized the institution of a pledge by concluding that the method, after almost 200 years in force, still leads to many conflicts because of the ambiguity of the principles detailed meaning.⁹⁰ This is somehow a good summary of the uncertainty that a pledge creates.

There are few, if any, present arguments to my knowledge that would contradict the conclusion that UCC Article 9 provides a superior security interest system. The potential operational costs for the system could be discussed and are hard to estimate. It could however be concluded that some costs already exist in relation to the current business mortgage system. These costs would cease and could therefore instead be used to cover part of the accruing costs for a registration based perfection system. It is of course of significance to perform a costs/benefit analysis, in an attempt to see if the system is economically defensible. This however is beyond the scope of this article. Another negative aspect of the UCC Article 9 system is its extensive nature, which tends to give it a structure that is hard to overview and comprehend. This however cannot defeat all the presented benefits that a reform would involve. In summary, the UCC Article 9 does not have to be a "buy all" concept; but it certainly has extensive value as a role model for future discussions within the Swedish legislature. The system is of course not flawless but it is a direct improvement and modernization of a Swedish system that no longer reflects commercial reality. An integrated and comprehensive system, such as the UCC Article 9, must be a solution that is superior to the enactment of piecemeal legislation, since it would be a system more tailored to fit the commercial reality of today's society.

90 NJA 2008 s. 684.

5.2 PUBLICITY

One of the purposes for the use of pledge is its publicity creating power. It generates publicity to other creditors of the fact that a debtor's assets are subject to security interests. A creditor should be able to assume that the assets in the possession of the debtor are free from security interests, due to the fact that they are not pledged into the possession of another creditor. This has been seen as essential for the facilitation of an evaluation of the debtor's creditworthiness. However, it is nowadays not uncommon that a debtor has assets in his possession due to a credit sale or hire. It is thus hard for a creditor to establish which property is owned by the creditor merely by looking at his possession.

Filing would offer publicity to an extent that is much greater than the publicity effect that pledge constitutes. It would set aside some of the publicity deficiencies that the use of pledge gives rise to. Filing of all security interests in one centralized system will give rise to a greater publicity-creating power. A potential creditor only needs to make a search in one uniform register to find out the extent of the security interests, this will thus create more accurate evaluation data when the debtor's creditworthiness is appraised. Furthermore, the high pace of technology development has made it possible to create an efficient filing system. The instant and easy access to both the Internet and databases, containing information regarding security interests, enhances the publicity effect that filing could offer.

As mentioned⁹¹ in the article, the efficiency of filing's publicity creating-power will be dependent upon the structure of the filing system. The UCC Article 9 allows for filing of a financing statement that uses super generic words, such as "all the debtor's assets", to describe the collateral subject to the security interest. This is a deficiency. The financing statement will, if a super generic word is used, merely give notice to other creditors and answer the question whether a further examination is needed or not. The security agreement does not, to the contrary, allow the use of super generic descriptions of the collateral. No reasons motivate differentiated description requirements. It would instead be beneficial to use equivalent description requirements in both the financing statement and the security agreement. There is no need for a differentiation due to the fact that the extent of the security interest will never be more extensive than its description in the security agreement. There is no rationale for saying

91 See Section 4.2.3.

that equivalent requirements will, in any manner, complicate the use of filing. The description that the parties use in the security agreement could easily be incorporated in the financing statement and consequently not cause any need for extra drafting. Equivalent requirements would instead be beneficial for the creditor, since it potentially would make the evaluating of the debtor's creditworthiness less complicated. If the financing statement would provide more accurate information about the security interest's extent, it would create fewer situations where the creditor needs to turn to either the debtor or the secured party for information about their transaction.

5.3 FRAUDULENT TRANSACTIONS

Pledge's preventive effect upon fraudulent transactions is seen as its most important function. The fact that possession is required is seen to complicate a debtor's attempt to "rescue" personal property from e.g. the claws of a bankruptcy trustee. Pledge, however, has one major deficiency that *Göransson* has pointed out by the saying "it takes two to tango". A sham or antedated transaction would of course require two persons acting together in an attempt to sham other creditors from assets. The fraudulent partners would then still have some opportunities to antedate the transaction and to pledge the collateral into the accomplice's possession without the knowledge of third parties. The accurate time of the pledge's occurrence would then be hard to establish if the credit agreement is antedated and no objective party has observed the actual time of the pledge. This is a deficiency, even if the extent is unclear, that strongly erodes the legitimate purpose of the pledge.

It is clear that perfection via filing offers a much greater preventive effect upon sham and antedated transactions. The, "it takes two to tango", problem would be precluded due to the fact that registration will take place in a centralized and objective filing system that cannot be bypassed. Since the time for perfection will then be decided by a fact that is objectively determinable, the possibility of fraudulent transaction would to a greater extent be prevented. The use of filing via an objective third party would hence be beneficial since it would much more efficiently prevent fraudulent transactions.

5.4 ORDERLINESS

The authoritative literature within Sweden has upheld orderliness as one of the important purposes that legitimize the use of pledge. Pledge creates, according to the literature, a reasonably simple and objective finding of fact that will lead to a reduced amount of priority conflicts. Although this effect has also been

questioned, the authors have overall agreed that some orderliness is created via pledge.

As previously mentioned, registration would be made via an objective third party, the filing office. It is obvious that perfection via filing would in a satisfactory manner create a system of perfection that would extend the clarity that pledge offers. A creditor that only has to search in one register would of course in a clearer and more distinct way be able to examine the standing of a debtor's assets. If a reformation in accordance with the UCC Article 9 would take place in Sweden and filing was to be the predominant perfection method, orderliness would be created to an extent that the current rules are far from achieving.

5.5 SURRENDER OF CONTROL

The surrender of control of the collateral that the pledge includes for the debtor has been seen to fulfill several purposes. It should e.g. prevent the debtor from entering into thoughtless lien agreements, protect unsecured creditors if bankruptcy occurs and prevent fraudulent transactions. It is obvious that use of filing at first sight will not fulfill this purpose since the collateral normally stays in the debtor's possession. The question is if the lack of surrender is as significant as it may appear at first sight. It is also necessary to determine if such a lack of surrender of control has any significance at all.

First of all, the surrender of control has, within the authoritative literature, been described as a purpose that lacks independence and importance. The purpose has also mainly been stated to prevent the debtor from entering into thoughtless lien agreements. There is a major error in the conclusion that surrender is needed to stop thoughtless lien agreements. The rationale is that a creditor will probably not enter into a credit transaction if the debtor's assets do not offer a security that to an accurate extent secures the obligation. Hence, thoughtless lien agreements would hence be unlikely since it also would require that the creditor expose itself to a severe risk of credit loss. Thoughtless lien agreements would thus be prevented due to creditors' unwillingness to expose themselves to a greater risk of credit loss. This reasoning of course excludes the fact that some creditors are willing to enter into credit transactions without a security but against a significant increase in interest rate. This type of creditor exists regardless of whether pledge or filing is used as the predominant perfection method and is thus no of importance since no collateral is given or evaluated.

Surrender of control has further been seen to protect unsecured creditors. This conclusion is based on the premise that unsecured creditors will receive distribution from the money collected by the sale of the debtor's assets that are not subject to a security interest. However, there once again exists a clear error when the effects of surrender are evaluated. It is widely known that unsecured creditors almost never receive any distribution when the bankruptcy trustee distributes the liquidating venture's assets in accordance to the Rights of Priority Act (Sw: *Förmånsrättslagen*). Thus, this effect of surrender can therefore to almost its full extent be regarded as obsolete and inaccurate. Lastly, *Hessler* has stated that the meaning of surrender in some context can be fulfilled by the mere fact that the existence of a security interest becomes public. Prospective creditors would, according to *Hessler*, be able to use their knowledge about the existing security interests and hence choose not to enter into a credit transaction with the debtor. *Hessler* believes that this to some extent can be regarded as a surrender made by the debtor.

5.6 THE PLEDGEE'S CONTROL OF THE COLLATERAL

The pledgee's control over the collateral has been seen to protect the pledgee from the pledgor's use of the collateral in a manner that might be harmful to the pledgee. Hence, this purpose is intended to protect the pledgee and not a third party interest. Filing would of course not offer such protection since its main characteristic is that the collateral remains within the possession of the pledgor. Despite the lack of fulfillment, its effect is only in regards to the pledgee and not in regards to any third party interest. Thus, a pledgee that fears for the value of the collateral can always contractually require that the collateral is pledged into his possession. The lack of fulfillment cannot render filing inappropriate, primarily due to the fact that the purpose only has effect *inter partes* and not vis-a-vi third parties. Another argument is that the Swedish perfection system, via the use of the Sale of Chattels Act, already offers a solution where the collateral remains in the possession of the pledgor. To deny filing due to the pledgee's lack of possession would therefore be inconsistent with the present system used in Sweden.

5.7 CONCLUSIONS

It is my conclusion that filing offers a better perfection solution than pledge. Filing together with a uniform and comprehensive system, like the UCC Article 9, will be beneficial since it will simplify, bring clarity to and meet the needs for a modern legislation within the security interest area. 